

**Chairperson and Committee Members**  
OPERATIONS & FINANCE COMMITTEE

12 APRIL 2018

Meeting Status: **Public**

Purpose of Report: For Information

**LOCAL GOVERNMENT FUNDING AGENCY DRAFT 2018/19  
STATEMENT OF INTENT**

**PURPOSE OF REPORT**

- 1 The purpose of this report is to update the Operations and Finance Committee on the Local Government Funding Agency (LGFA) draft 2018/19 Statement of Intent (SOI).

**DELEGATION**

- 2 The Operations & Finance Committee has delegated authority to consider this Report under the following delegation in the Governance Structure and Delegations, Section B.2 which states that the key responsibilities of the Committee will include: *Financial Management, including risk mitigation.*

**BACKGROUND**

- 3 The LGFA was incorporated on 1 December 2011 with the primary objective of optimising the debt funding terms and conditions for participating local authorities. This includes providing savings in annual interest costs, making longer-term borrowings available and enhancing the certainty of access to debt markets.
- 4 The LGFA issues bonds to wholesale and retail investors and on-lends the funds raised to participating local authorities with borrowing needs. The quality of the LGFA's credit rating and the liquidity created by issuing homogenous local authority paper, ensures that participating councils can raise funds on better terms than if they were issuing in their own name.
- 5 On 30 November 2012, Kapiti Coast District Council (Council) became a principal shareholding local authority<sup>1</sup> in the LGFA. The LGFA meets the Local Government Act (LGA) 2002 definition of a Council Controlled Organisation (CCO) and as a shareholder in a CCO, the Council must regularly undertake performance monitoring of that organisation to evaluate its contribution to the achievement of the Council's desired outcomes.
- 6 As a CCO, the LGFA must deliver to its shareholders a draft SOI on or before 1 March each year. The LGFA board must consider any comments from its shareholders in relation to the draft SOI and deliver a final SOI on or before 30 June.

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<sup>1</sup> principal shareholding local authorities are those which invest capital in the LGFA and are expected to receive a return on that capital.

- 7 The Council's monitoring obligations are assisted by the Shareholders' Council whose role it is to represent all the shareholders and ensure that all individual shareholder views are heard. The Shareholders' Council comprises five to ten appointees from the council shareholders and one from the Crown.

## ISSUES AND OPTIONS

### Issues

- 8 The report summarises the key intentions and expectations of the LGFA draft 2018/19 SOI.
- 9 The LGFA's objectives and operating intentions are consistent with the 2017/18 SOI and its primary objective continues to be optimising debt funding terms and conditions for its members. Furthermore the LGFA is not proposing to change any of its performance objectives, or their associated measures, despite the difficulty in achieving some of its performance targets in the current and previous years.
- 10 The LGFA financial forecasts show that it expects to continue performing strongly, despite potential volatility around the refinancing of loans in each of the three years of the SOI forecast. Forecast surpluses for the three years of the 2018/19 SOI are \$35.3 million compared with \$28.3 million for the three years of the 2017/18 SOI. Retained earnings are forecast to grow from \$29 million at 30 June 2017 to \$70 million at 30 June 2021, giving total equity of \$95 million.
- 11 The LGFA has a capital adequacy policy which states that the LGFA's equity (this includes borrower notes which are debt securities that can be converted to equity under specific circumstances) must always be at least 1.60% of its total assets. The capital adequacy is a measure of the LGFA's financial strength and stability; maintaining the ratio ensures the LGFA does not over-extend itself by taking on too much debt.
- 12 The LGFA forecasts a capital adequacy ratio of 2.40% to 2.64% over the course of the 2018/19 SOI. It might be argued that this is too high and that the LGFA is holding higher levels of reserves than is strictly necessary, which does not align with the stated objective of maximising benefits to participating local authorities. A lower capital adequacy ratio (still above the required 1.60%) would lead to increased savings for borrowers and help the LGFA to achieve its performance target for borrowings margins on-charged to councils.
- 13 The key performance target the LGFA uses to assess its achievement in providing savings in annual interest costs for all participating local authorities:
- the average base margin above the LGFA's cost of funds charged to the highest rated<sup>2</sup> participating authorities will be no more than 0.10% for the three years covered by the 2018/19 SOI.

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<sup>2</sup> the highest rated participating authorities have a Standard and Poor's credit rating of AA; the Kāpiti Coast District Council has a Standard and Poor's credit rating of A+.

- 14 This target was lowered from 0.15% to 0.10% in 2015/16 and the LGFA has not yet achieved this revised target. It notes that this on-lending margin target is unlikely to go any lower, as its margins are the narrowest when compared to its international peers.
- 15 Council officers do not recommend any changes to the draft SOI and therefore it is appropriate to seek approval from the Council to advise LGFA that Council is satisfied with the draft SOI.
- 16 The LGFA final 2018/19 Statement of Intent is attached as Appendix 1.

## **CONSIDERATIONS**

### Policy considerations

- 17 In accordance with the LGA 2002, the Council has provided information on all of its CCOs in its draft 2018/38 Long Term Plan.

### Legal considerations

- 18 There are no legal considerations arising from the matters in this report.

### Financial considerations

- 19 There are no financial considerations arising from this report.

### Tāngata whenua considerations

- 20 There are no tāngata whenua considerations.

## **SIGNIFICANCE AND ENGAGEMENT**

### Degree of significance

- 21 This matter has a low level of significance under the Council's Significant and Engagement Policy.

### Consultation already undertaken

- 22 There is no need to consult on the matters discussed in this report.

### Engagement planning

- 23 An engagement plan is not needed for this report to be considered.

### Publicity

- 24 There are no publicity considerations.

## RECOMMENDATIONS

- 25 That the Operations and Finance Committee notes the contents of the Local Government Funding Agency draft 2018/19 Statement of Intent.
- 26 That the Operations and Finance Committee advises the Local Government Funding Agency that it does not seek any amendments to the draft Statement of Intent.

**Report prepared by**

**Approved for submission**

**Approved for submission**

**Jacinta Straker  
Chief Financial Officer**

**Janice McDougall  
Acting Group Manager  
Corporate Services**

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Group Manager  
Strategy and Planning**

Appendix 1 – LGFA draft 2018/19 Statement of Intent



## Draft Statement of Intent 2018/19

### 1. Introduction

This Statement of Intent (SOI) sets out the intentions and expectations of New Zealand Local Government Funding Agency Limited (LGFA).

The LGFA is enabled under the Local Government Borrowing Act 2011 and is a council-controlled organisation (CCO) for the purposes of the Local Government Act 2002.

The SOI is prepared in accordance with section 64(1) of the Local Government Act 2002.

### 2. Nature and scope of activities

LGFA will raise debt funding either domestically and/or offshore in either NZ dollars or foreign currency and provide debt funding to New Zealand local authorities, and may undertake any other activities considered by the Board of LGFA to be reasonably related or incidentally to, or in connection with, that business.

The LGFA will only lend to local authorities that enter into all the relevant arrangements with it (Participating Local Authorities) and comply with the LGFA's lending policies.

In lending to Participating Local Authorities, LGFA will:

- Operate in a manner to ensure LGFA is successful and sustainable in the long-term;
- Educate and inform Participating Local Authorities on matters within the scope of LGFA's operations;
- Provide excellent service to Participating Local Authorities;
- Ensure excellent communication exists and be professional in its dealings with all its stakeholders; and
- Ensure its products and services are delivered in a cost-effective manner.

### **3. Objectives**

#### **Principal Objectives**

In accordance with the Local Government Act 2002, in carrying on its business, the principal objectives of LGFA will be to:

- Achieve the objectives and performance targets of the shareholders in LGFA (both commercial and non-commercial) as specified in this SOI;
- Be a good employer;
- Exhibit a sense of social and environmental responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so; and
- Conduct its affairs in accordance with sound business practice.

#### **Primary Objectives**

LGFA will operate with the primary objective of optimising the debt funding terms and conditions for Participating Local Authorities. Among other things this includes:

- Providing savings in annual interest costs for all Participating Local Authorities on a relative basis to other sources of financing;
- Making longer-term borrowings available to Participating Local Authorities;
- Enhancing the certainty of access to debt markets for Participating Local Authorities, subject always to operating in accordance with sound business practice; and
- Offering more flexible lending terms to Participating Local Authorities.

LGFA will monitor the quality of the asset book so that it remains of a high standard by ensuring it understands each Participating Local Authority's financial position and the general issues confronting the Local Government sector. This includes

- LGFA will review each Participating Local Authority's financial position, its financial headroom under LGFA policies and endeavour to visit each Participating Local Authority on an annual basis;
- LGFA will analyse finances at the Council group level where appropriate;
- LGFA will review its debt covenant methodology and assessment of council financial position at group vs parent. LGFA will present its findings to councils at the LGFA Shareholder-Borrower Day, including a comparison of LGFA methodology to that of the credit rating agencies;
- LGFA will work closely with the Department of Internal Affairs (DIA), Office of the Auditor General (OAG) and Local Government New Zealand (LGNZ) on sector and individual council issues; and
- LGFA will take a proactive role to enhance the financial strength and depth of the local government debt market.

## **Additional objectives**

LGFA has a number of additional objectives which complement the primary objective. These objectives will be measurable and achievable and the performance of the company in achieving its objectives will be reported annually. These additional objectives are to:

- Operate with a view to making a profit sufficient to pay a dividend in accordance with its stated Dividend Policy set out in section 6;
- Provide at least 50% of aggregate long-term debt funding to the Local Government sector;
- Ensure its products and services are delivered at a cost that does not exceed the forecast for issuance and operating expenses set out in section 4;
- Take appropriate steps to ensure compliance with the Health and Safety at Work Act 2015;
- Maintain LGFA's credit rating equal to the New Zealand Government sovereign rating where both entities are rated by the same Rating Agency;
- Achieve the Financial Forecasts (excluding the impact of AIL) set out in section 4;
- Meet or exceed the Performance Targets outlined in section 5; and
- Comply with its Treasury Policy, as approved by the Board.

#### 4. Financial forecasts

LGFA's financial forecasts for the three years to 30 June 2021 are:

##### FINANCIAL YEAR (\$M)

<b>Comprehensive income</b>	<b>Jun-19</b>	<b>Jun-20</b>	<b>Jun-21</b>
Interest income	239.11	241.42	254.38
Interest expense	220.64	223.71	232.86
<b>Net Interest income</b>	<b>18.46</b>	<b>17.71</b>	<b>21.53</b>
Issuance and on-lending costs	2.44	2.47	2.50
Approved Issuer Levy	2.07	1.56	1.61
Operating expenses	3.14	3.24	3.33
<b>Issuance and operating expenses</b>	<b>7.65</b>	<b>7.27</b>	<b>7.44</b>
<b>P&amp;L</b>	<b>10.81</b>	<b>10.44</b>	<b>14.08</b>

<b>Financial position (\$m)</b>	<b>Jun-19</b>	<b>Jun-20</b>	<b>Jun-21</b>
Capital	25.00	25.00	25.00
Retained earnings	48.30	57.42	70.10
Total equity	73.30	82.42	95.10
Shareholder funds + borrower notes / Total assets	2.40%	2.49%	2.64%
Dividend provision	1.33	1.40	1.45
Total assets (nominal)	8,170.25	8,414.20	8,447.97
Total LG loans - short term (nominal)	325.00	325.00	325.00
Total LG loans (nominal)	7,695.00	7,936.50	7,972.50
Total bills (nominal)	370.00	370.00	370.00
Total bonds (nominal) ex tsy stock	7,699.00	7,839.00	7,829.00
Total borrower notes (nominal)	123.12	126.98	127.56

Note that there is some forecast uncertainty around the timing of Net Interest Revenue, Net Profit, Total Assets, LG Loans, Bonds and Borrower Notes depending upon council decisions regarding the amount and timing of refinancing of their March 2019, April 2020 and May 2021 loans. LGFA will work with council borrowers to reduce this uncertainty.

## 5. Performance targets

LGFA has the following performance targets:

- The average margin above LGFA's cost of funds charged to the highest rated Participating Local Authorities for the period to:
  - 30 June 2019 will be no more than 0.10%.
  - 30 June 2020 will be no more than 0.10%.
  - 30 June 2021 will be no more than 0.10%.

The above indicators include both LGFA Bills and Bonds and short dated and long dated lending to councils.

- LGFA's annual issuance and operating expenses (excluding AIL) for the period to:
  - 30 June 2019 will be less than \$5.58 million.
  - 30 June 2020 will be less than \$ 5.71 million.
  - 30 June 2021 will be less than \$5.83 million.
- Total lending to Participating Local Authorities<sup>1</sup> at:
  - 30 June 2019 will be at least \$8,020 million.
  - 30 June 2020 will be at least \$8,261 million.
  - 30 June 2021 will be at least \$8,297 million.
- Savings on borrowing costs for council borrowers:
  - LGFA will demonstrate the savings to council borrowers on a relative basis to other sources of financing. This will be measured by maintaining or improving the prevailing secondary market spread between LGFA bonds and those bonds of a similar maturity issued by (i) registered banks and (ii) Auckland Council and Dunedin Council as a proxy for single name issuance of council financing.

## 6. Dividend policy

LGFA will seek to maximise benefits to Participating Local Authorities as Borrowers rather than Shareholders. Consequently, it is intended to pay a limited dividend to Shareholders.

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<sup>1</sup> Subject to the forecasting uncertainty noted previously

The Board's policy is to pay a dividend that provides an annual rate of return to Shareholders equal to LGFA fixed rate bond cost of funds plus 2.00% over the medium term.

At all times payment of any dividend will be discretionary and subject to the Board's legal obligations and views on appropriate capital structure.

## **7. Governance**

### **Board**

The Board is responsible for the strategic direction and control of LGFA's activities. The Board guides and monitors the business and affairs of LGFA, in accordance with the Companies Act 1993, the Local Government Act 2002, the Local Government Borrowing Act 2011, the Company's Constitution, the Shareholders' Agreement for LGFA and this SOI.

The Board comprises six directors with five being independent directors and one being a non-independent director.

The Board's approach to governance is to adopt best practice<sup>2</sup> with respect to:

- The operation of the Board.
- The performance of the Board.
- Managing the relationship with the Company's Chief Executive.
- Being accountable to all Shareholders.

All directors are required to comply with a formal Charter, to be reviewed from time to time in consultation with Shareholders.

The Board will meet on a regular basis and no fewer than 6 times each year.

### **Shareholders' Council**

The Shareholders' Council is made up of between five and ten appointees of the Shareholders (including an appointee from the Crown). The role of the Shareholders' Council is to:

- Review the performance of LGFA and the Board, and report to Shareholders on that performance on a periodic basis.
- Make recommendations to Shareholders as to the appointment, removal, replacement and remuneration of directors.
- Make recommendations to Shareholders as to any changes to policies, or the SOI, requiring their approval.
- Ensure all Shareholders are fully informed on LGFA matters and to coordinate Shareholders on governance decisions.

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<sup>2</sup> Best practice as per NZX and Institute of Directors guidelines

## **8. Information to be provided to Shareholders**

The Board aims to ensure that Shareholders are informed of all major developments affecting LGFA's state of affairs, while at the same time recognising both LGFA's obligations under NZX Listing Rules and that commercial sensitivity may preclude certain information from being made public.

### **Annual Report**

The LGFA's balance date is 30 June.

By 30 September each year, the Company will produce an Annual Report complying with Sections 67, 68 and 69 of the Local Government Act 2002, the Companies Act and Financial Reporting Act. The Annual Report will contain the information necessary to enable an informed assessment of the operations of the company, and will include the following information:

- Directors' Report.
- Financial Statements incorporating a Statement of Financial Performance, Statement of Movements in Equity, Statement of Financial Position, Statement of Cashflows, Statement of Accounting Policies and Notes to the Accounts.
- Comparison of the LGFA's performance with regard to the objectives and performance targets set out in the SOI, with an explanation of any material variances.
- Auditor's Report on the financial statements and the performance targets.
- Any other information that the directors consider appropriate.

### **Half Yearly Report**

By 28 February each year, the Company will produce a Half Yearly Report complying with Section 66 of the Local Government Act 2002. The Half Yearly Report will include the following information:

- Directors' commentary on operations for the relevant six-month period.
- Comparison of LGFA's performance with regard to the objectives and performance targets set out in the SOI, with an explanation of any material variances.
- Un-audited half-yearly Financial Statements incorporating a Statement of Financial Performance, Statement of Movements in Equity, Statement of Financial Position and Statement of Cashflows.

### **Quarterly Report**

By 31 January, 30 April, 31 July, and 31 October each year, the Company will produce a Quarterly Report. The Quarterly Report will include the following information:

- Commentary on operations for the relevant quarter, including a summary of borrowing margins charged to Participating Local Authorities (in credit rating bands).
- Comparison of LGFA's performance with regard to the objectives and performance targets set out in the SOI, with an explanation of any material variances.

- Analysis of the weighted average maturity of LGFA bonds outstanding.
- In the December Quarterly Report only, commentary on the Net Debt/Total Revenue percentage for each Participating Local Authority that has borrowed from LGFA (as at the end of the preceding financial year).
- To the extent known by LGFA, details of all events of review in respect of any Participating Local Authority that occurred during the relevant quarter (including steps taken, or proposed to be taken, by LGFA in relation thereto).

### **Statement of Intent**

By 1 March in each year the Company will deliver to the Shareholders its draft SOI for the following year in the form required by Clause 9(1) of Schedule 8 and Section 64(1) of the Local Government Act 2002.

Having considered any comments from the Shareholders received by 30 April, the Board will deliver the completed SOI to the Shareholders on or before 30 June each year.

### **Shareholder Meetings**

The Board will hold an Annual General Meeting between 30 September and 30 November each year to present the Annual Report to all Shareholders.

The Company will hold a meeting with the Shareholders' Council approximately every six months – prior to the Annual General Meeting and after the Half Yearly Report has been submitted. Other meetings may be held by agreement between the Board and the Shareholders' Council.

## **9. Acquisition/divestment policy**

LGFA will invest in securities in the ordinary course of business. It is expected that these securities will be debt securities. These investments will be governed by LGFA's lending and/or investment policies as approved by the Board and/or Shareholders.

Any subscription, purchase or acquisition by LGFA of shares in a company or organisation will, if not within those investment policies, require Shareholder approval other than as concerns the formation of wholly-owned subsidiaries and the subscription of shares in such wholly-owned subsidiaries.

## **10. Activities for which compensation is sought from Shareholders**

At the request of Shareholders, LGFA may (at its discretion) undertake activities that are not consistent with its normal commercial objectives. Specific financial arrangements will be entered into to meet the full cost of providing such as activities.

Currently there are no activities for which compensation will be sought from Shareholders.

## **11. Commercial value of Shareholder's investment**

LGFA will seek to maximise benefits to Participating Local Authorities as Borrowers rather than Shareholders.

Subject to the Board's views on the appropriate capital structure for LGFA, the Board's intention will be

to pay a dividend that provides an annual rate of return to Principal Shareholders equal to LGFA fixed rate bond cost of funds plus 2.00% over the medium term.

As the Shareholders will have invested in the LGFA on the basis of this limited dividend, the Board considers that at establishment the commercial value of LGFA is equal to the face value of the Shareholders' paid up Principal Shares - \$25 million.

In the absence of any subsequent share transfers to the observed share transfers on 30 November 2012, the Board considers the current commercial value of LGFA is at least equal to the face value of the Shareholders' paid up Principal Shares - \$25 million.

## **12. Accounting policies**

LGFA has adopted accounting policies that are in accordance with the New Zealand International Financial Reporting Standards and generally accepted accounting practice. A Statement of accounting policies is attached to this SOI.

**The following statement is taken from the Financial Statements presented as part of LGFA's Annual Report 2017 (updated where necessary).**

### **ATTACHMENT: Statement of accounting policies**

#### **a. Reporting Entity**

The New Zealand Local Government Funding Agency Limited (LGFA) is a company registered under the Companies Act 1993 and is subject to the requirements of the Local Government Act 2002.

LGFA is controlled by participating local authorities and is a council-controlled organisation as defined under section 6 of the Local Government Act 2002. LGFA is a limited liability company incorporated and domiciled in New Zealand.

The primary objective of LGFA is to optimise the debt funding terms and conditions for participating local authorities.

The registered address of LGFA is Level 8, City Chambers, 142 Featherston Street, Wellington Central, Wellington 6011.

#### **b. Statement of Compliance**

LGFA is an FMC reporting entity under the Financial Markets Conduct Act 2013 (FMCA). These financial statements have been prepared in accordance with that Act and the Financial Reporting Act 2013. LGFA's bonds are quoted on the NZX Debt Market.

LGFA is a profit orientated entity as defined under the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS).

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP) and they comply with NZ IFRS and other applicable Financial Reporting Standard, as appropriate for Tier 1 for-profit entities. The financial statements also comply with International Financial Reporting Standards (IFRS).

## **c. Basis of Preparation**

### **Measurement base**

The financial statements have been prepared on a historical cost basis modified by the revaluation of certain assets and liabilities.

The financial statements are prepared on an accrual basis.

### **Functional and presentation currency**

The financial statements are presented in New Zealand dollars rounded to the nearest thousand, unless separately identified. The functional currency of LGFA is New Zealand dollars.

### **Foreign currency conversions**

Transactions denominated in foreign currency are translated into New Zealand dollars using exchange rates applied on the trade date of the transaction.

### **Changes in accounting policies**

There have been no changes in accounting policies.

### **Early adoption standards and interpretations**

NZ IFRS 9: Financial Instruments. The first two phases of this new standard were approved by the Accounting Standards Review Board in November 2009 and November 2010. These phases address the issues of classification and measurement of financial assets and financial liabilities.

### **Standards not yet adopted**

LGFA does not consider any standards or interpretations in issue but not yet effective to have a significant impact on its financial statements. Those which may be relevant to LGFA are as follows:

NZ IFRS 9: Financial Instruments (2014) – Effective for periods beginning on or after 1 January 2018. This standard aligns hedge accounting more closely with the risk management activities of the entity and adds requirements relating to the accounting for an entity's expected credit losses on its financial assets and commitments to extend credit.

## **d. Financial instruments**

### **Financial assets**

Financial assets, other than derivatives, are recognised initially at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method.

Cash and cash equivalents include cash on hand; cash in transit, bank accounts and deposits with an original maturity of no more than three months.

Purchases and sales of all financial assets are accounted for at trade date.

At each balance date an assessment is made whether a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired when objective evidence

demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

### **Financial liabilities**

Financial liabilities, other than derivatives, are recognised initially at fair value less transaction costs and subsequently measured at amortised cost using the effective interest rate method.

### **Derivatives**

Derivative financial instruments are recognised both initially and subsequently at fair value. They are reported as either assets or liabilities depending on whether the derivative is in a net gain or net loss position respectively.

### **Fair value hedge**

Where a derivative qualifies as a hedge of the exposure to changes in fair value of an asset or liability (fair value hedge) any gain or loss on the derivative is recognised in profit and loss together with any changes in the fair value of the hedged asset or liability.

The carrying amount of the hedged item is adjusted by the fair value gain or loss on the hedged item in respect of the risk being hedged. Effective parts of the hedge are recognised in the same area of profit and loss as the hedged item.

### **e. Other assets**

#### **Property, plant and equipment (PPE)**

Items of property, plant and equipment are initially recorded at cost.

Depreciation is charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of property, plant and equipment, less any estimated residual value, over its remaining useful life.

#### **Intangible Assets**

Intangible assets comprise software and project costs incurred for the implementation of the treasury management system. Capitalised computer software costs are amortised on a straight line basis over the estimated useful life of the software (three to seven years). Costs associated with maintaining computer software are recognised as expenses.

### **f) Other liabilities**

#### **Employee entitlements**

Employee entitlements to salaries and wages, annual leave and other similar benefits are recognised in the profit and loss when they accrue to employees.

### **g) Revenue and expenses**

#### **Revenue**

#### **Interest income**

Interest income is accrued using the effective interest rate method.

The effective interest rate exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. The method applies this rate to the principal outstanding to determine interest income each period.

### **Expenses**

Expenses are recognised in the period to which they relate.

### **Interest expense**

Interest expense is accrued using the effective interest rate method.

The effective interest rate exactly discounts estimated future cash payments through the expected life of the financial liability to that liability's net carrying amount. The method applies this rate to the principal outstanding to determine interest expense each period.

### **Income tax**

LGFA is exempt from income tax under Section 14 of the Local Government Borrowing Act 2011.

### **Goods and services tax**

All items in the financial statements are presented exclusive of goods and service tax (GST), except for receivables and payables, which are presented on a GST-inclusive basis. Where GST is not recoverable as input tax, then it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the IRD is included as part of receivables or payables in the statement of financial position.

The net GST paid to, or received from the IRD, including the GST relating to investing and financing activities, is classified as a net operating cash flow in the statement of cash flows.

Commitments and contingencies are disclosed exclusive of GST.

#### **h. Lease payments**

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

#### **i. Segment reporting**

LGFA operates in one segment being funding of participating local authorities in New Zealand.

#### **j. Judgements and estimations**

The preparation of these financial statements requires judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and income and expenses. For example, the present value of large cash flows that are predicted to occur a long time into the future depends critically on judgements regarding future cash flows, including inflation assumptions and the risk-free discount rate used to calculate present values. Refer note 2b for fair value determination for financial instruments.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised, if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Where these judgements significantly affect the amounts recognised in the financial statements they are described below and in the following notes.